No. _____

IN THE
Supreme Court of the United States

COUNTY BANK OF REHOBOTH BEACH, DELAWARE AND MAIN STREET SERVICE CORPORATION,

Petitioners,

v.

JALIYAH MUHAMMAD,

Respondent.

On Petition for a Writ of Certiorari to the Supreme Court of New Jersey

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PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

This case, in which the New Jersey Supreme Court determined that the class arbitration waiver contained in the parties' arbitration agreement was unconscionable and unenforceable because the Respondent's claim was a "low value" consumer claim, presents the following three questions:

- Whether the New Jersey Supreme Court erroneously ruled – in conflict with the Federal Arbitration Act, this Court's precedents and multiple state courts and federal courts of appeal – that a class arbitration waiver in an otherwise enforceable arbitration agreement is unenforceable and must be stricken;

- Whether the New Jersey Supreme Court's ruling violates Petitioners' right to due process because it applies a new interpretation of New Jersey law retroactively to the parties; and,

- Whether the New Jersey Supreme Court's ruling unduly burdens interstate commerce by seeking to impose special requirements on arbitration agreements that are contrary to the Federal Arbitration Act.

PARTIES TO THE PROCEEDING AND RULE 29.6 STATEMENT

Petitioners County Bank of Rehoboth Beach, Delaware and Main Street Service Corporation were defendants, appellees and respondents below. Easy Cash and Telecash, named as defendants, appellees and respondents below, are trade names of County Bank and not listed here.

Respondent Jaliyah Muhammad was plaintiff, appellant and petitioner below.

Pursuant to S. Ct. Rule 29.6, Petitioners state that there is no parent or publicly held company that owns 10% or more of the stock of County Bank of Rehoboth Beach, Delaware or Main Street Service Corporation.

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County Bank of Rehoboth Beach, Delaware ("County Bank") and Main Street Service Corporation ("Main Street") respectfully petition for a writ of certiorari to review the judgment of the New Jersey Supreme Court in this case.

OPINIONS BELOW

The opinion of the New Jersey Supreme Court entitled *Muhammad v. County Bank et al.*, is not yet reported (although it is available at 2006 WL 2273448) and reprinted in the attached Appendix A ("App."). The order of the New Jersey Supreme Court denying reconsideration of its decision is unreported and reprinted at App. E. The opinion of the New Jersey Superior Court, Appellate Division is reported at 379 N.J. Super. 222 (2005) and reprinted at App. B. The New Jersey Superior Court Trial Division's order granting the Petitioners' Motion to Stay Action Pending Arbitration and Compel Arbitration is unreported and reprinted at App. C.

JURISDICTION

The New Jersey Supreme Court issued its decision on August 9, 2006. App. A. The court denied rehearing on October 5, 2006. App. E. Petitioners invoke this Court's jurisdiction pursuant to 28 U.S.C. § 1257.

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The Supremacy Clause of the United States Constitution, U.S. Const., art. VI, cl. 2:

> This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; * * * shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the

Constitution or Laws of any state to the Contrary notwithstanding.

The Fourteenth Amendment to the United States Constitution, U.S. Const. amend. XIV, § 1:

> No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.

The Commerce Clause of the United States Constitution, U.S. Const. art I, sec. 8, cl. 3:

> The Congress shall have power * * * To regulate Commerce with foreign Nations, and among the several States * * *

Section 2 of the Federal Arbitration Act, 9 U.S.C. § 2 ("FAA"):

> A written provision in any * * * contract evidencing a transaction involving interstate commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction * * * shall be valid, irrevocable, and enforceable, save upon such grounds as exist in law or equity for the revocation of any contract.

INTRODUCTION

Muhammad presents three constitutional issues, one of which has sharply split multiple state and federal courts, while the other two are challenges to long established commerce clause and due process principles.

First, if the terms of the agreement to arbitrate expressly preclude class procedure, can a state court alter that agreement in any way? Is such a ruling preempted by the FAA? This Court posed these questions without answering them in *Southland Corp. v. Keating*, 465 U.S. 1 (1984), and the time is now right for an answer.

Second, this Court disfavors retroactivity in the law. Ignoring this Court's precedent, the New Jersey Supreme Court applied a new interpretation of its law retroactively, imposing its new interpretation on parties previously in compliance with both New Jersey law as it existed at the time of their contracts and Delaware state law, which the parties chose as governing law in their agreement. The unconstitutionality of New Jersey's retroactive application of the law requires this Court's review.

Third, the Constitution vests power to regulate interstate commerce in Congress. State regulation of interstate commerce must yield to Congress' expressed intent, yet New Jersey will not. *Muhammad's* holding imposes far-reaching burdens on interstate commerce where Congress has clearly expressed its intent that arbitration clauses in contracts affecting interstate commerce be favored, rather than burdened.

These issues need certiorari review now.

- **The Circuits and the States are split. S. Ct. Rule 10(b).**

The New Jersey Supreme Court joins California and the U.S. Courts of Appeal for the First and Ninth Circuits as jurisdictions choosing to treat arbitration agreements in "low value" cases differently than other contracts. As discussed below at pp. 15-17, these jurisdictions have held that the class action waivers included in arbitration agreements are

unenforceable in low value consumer cases. In contrast, many state and federal circuits hold either that courts may not order class wide arbitration unless the parties have so agreed, or that, if the parties have agreed not to arbitrate as a class, the contract between the parties is not unconscionable.

The Seventh Circuit, for example, has held that courts are without authority to order class-wide arbitration unless the parties have expressly agreed to that procedure. *Champ v. Siegel Trading Co.*, 55 F.3d 269, 276-277 (7th Cir. 1995). The Third, Fourth, Eighth, and Eleventh Circuits—unlike the New Jersey Supreme Court—have enforced arbitration agreements despite the unavailability of class action procedures under those agreements.[1] The decision below likewise conflicts with the decisions of the Second, Fifth, Sixth, Eighth, and Eleventh Circuits, all of which have reached the related conclusion that the FAA precludes courts from requiring consolidation of arbitration proceedings unless the parties expressly agreed to do so in their arbitration agreements.[2]

- **The New Jersey ruling directly conflicts with the decisions of this Court. S. Ct. Rule 10(c).**

This Court often has admonished that arbitration agreements must be enforced according to their terms—even in more drastic cases, such as when enforcement of the agreement results in piecemeal litigation of the contracting parties' claims or an order to compel arbitration of a contract

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[1] *Snowden v. Checkpoint Check Cashing*, 290 F.3d 631, 638-639 (4th Cir. 2002), *Dominium Austin Partners, L.L.C. v. Emerson*, 248 F.3d 720 (8th Cir. 2001); *Randolph v. Green Tree Fin. Corp.*, 244 F.3d 814, 817-818 (11th Cir. 2001); *Johnson v. West Suburban Bank*, 225 F.3d 366, 369 (3d Cir. 2000), cert. denied, 531 U.S. 1145 (2001).

[2] *See* pp. 15-16, below.

that is eventually determined to be void *ab initio*. This Court previously has recognized that an arbitration agreement may be enforced "even if the arbitration could not go forward as a class action. . ." *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 32 (1991) (internal quotation omitted). The New Jersey ruling conflicts with this Court's application of the FAA.

A plurality of this Court also stated in *Green Tree Financial Corp. v. Bazzle*, 539 U.S. 444 (2003), that where an arbitration agreement is silent as to whether the parties consent to class arbitration, an arbitrator must decide that issue. The Court's ruling implies that parties are free to permit or prohibit class arbitration. It would be improper, then, to strike the parties' statement of intent from the arbitration agreement, yet the New Jersey Supreme Court decision does so, interfering with the parties' right to contract according to their own terms. As the late Chief Justice Rehnquist, joined by Justices O'Connor and Kennedy in his dissent in *Bazzle*, stated, a state supreme court decision imposing class arbitration upon parties who impliedly provided otherwise "imposed a regime that was contrary to the express agreement of the parties" and thereby violated the FAA. 539 U.S. at 459 (Rehnquist, C.J., dissenting).

The Court also has held that a new law, or new interpretation of an existing law, should be applied only prospectively. *Bowen v. Georgetown Univ. Hospital*, 488 U.S. 204, 208 (1988) ("Retroactivity is not favored in the law."). The New Jersey Supreme Court applied its "low value" distinction to arbitration agreements which, prior to its ruling, had not been unconscionable. Because this Court has held that a court may not automatically apply a change in the law retroactively where the application of that law attaches new legal consequences to completed, past conduct that was legal at the time, see *Usery v. Turner Elkhorn*

Mining Co., 428 U.S. 1, 15-16 (1976), the New Jersey ruling conflicts with this Court's precedent.

- **The conflict concerns a matter of overriding national importance. S. Ct. Rule 10(c).**

The New Jersey Supreme Court's decision in this case contravenes the central purpose of the FAA: enforcing arbitration agreements according to their terms. The conflict between New Jersey's new law and that of the majority of states has nationwide implications. Tens of thousands of standard commercial and consumer contracts contain arbitration provisions. In most of the rest of the country, courts enforce arbitration agreements as written, declining to rewrite them either to exclude an agreed upon class action waiver or include a class procedure to which the contracting parties did not agree. Thus, parties to standard contracts containing standard arbitration provisions face the prospect of starkly different proceedings arising from those contracts—all depending on whether they sue or are sued in New Jersey, or elsewhere.

In *Southland Corp. v. Keating*, *supra*, this Court noted probable jurisdiction to determine whether the California Supreme Court's ruling imposing a class action structure on an arbitration conflicted with the FAA. This Court concluded that it could not exercise jurisdiction over that question because it had not been raised adequately below. *Id.* at 9. The question left open in *Southland* still vexes the nation's lower courts and is squarely presented by this case. The conflict between the New Jersey Supreme Court's approach and that of most federal and state courts of appeal highlights a conflict that has only deepened in the intervening years—as is evidenced by the recent proliferation of petitions for certiorari on this and related issues. Certiorari should be granted to resolve, at last, this important question.

STATEMENT OF THE CASE

Jaliyah Muhammad ("Muhammad") sought out County Bank, a federally-insured, Delaware chartered depository institution, for a loan. App. B at 5. On or about April 28, 2003, she requested a short term, single advance, unsecured $ 200.00 loan. *Id.* at 6. To obtain the loan, County Bank's loan servicer, Main Street, faxed an application form to Muhammad, who completed, signed and faxed the completed application back to Main Street. *Id.*

After County Bank approved the loan, it transmitted funds directly to Muhammad's checking account via an ACH credit entry transaction. *Id.* at 7. Muhammad repeated this process for two additional loans, one on May 23, 2003 and another on June 6, 2003, each for $200.00. *Id.*

Muhammad's loans are evidenced by Note and Disclosure Statements ("Notes"). *Id.* The Notes clearly identify County Bank as the lender, a fact which Muhammad does not dispute. *Id.* at 5. Like the loan application, the Notes were received by facsimile, signed by Muhammad, and returned by facsimile to County Bank's loan servicer, Main Street. *Id.* at 6. The terms of the loans are clearly and prominently set forth in the Notes, including the annual percentage rate ("APR") and finance charge. *Id.* at 7.

The Notes also contain a choice of law clause providing that Delaware law governs the agreement and the relationship of the parties, except as federal law applies. App. H at 3. In addition, each of the Notes advised

Muhammad that County Bank had retained Main Street to service her loan. App. B. at 6.[3]

The Notes contain the following binding arbitration agreement above Muhammad's signature:

> AGREEMENT TO ARBITRATE ALL DISPUTES:
> You [the borrower] and we [County Bank] agree that any and all claims, disputes or controversies between you and us and/or the Company [defined as Main Street in the Notes], any claim by either of us against the other or the Company (or the employees, officers, directors, agents, or assigns of the other or the Company) and any claim arising from or relating to your application for this loan or any other loan you previously, now or may later obtain from us, this Loan Note, this agreement to arbitrate all disputes, your agreement not to bring, join or participate in class actions, regarding collection of the loan, alleging fraud or misrepresentation, whether under the common law or pursuant to federal, state or local statute, regulation or ordinance, including disputes as to the matters subject to arbitration, or otherwise, shall be resolved by binding individual (and not joint) arbitration by and under the Code of Procedure of the National Arbitration Forum ("NAF") in effect at the time the claim is filed. . . Your arbitration fees may be waived by the NAF in the event you cannot afford to pay them. The cost of any participatory, documentary or telephone hearing, if one is held at your or our request, will be paid for solely by us as provided in the NAF Rules and, if a participatory hearing is requested, it will take place at a

[3] Muhammad listed two County Bank trade names, "Easy Cash" and "Telecash" as defendants. County Bank used these trade names in connection with the advertising and marketing of its short term loans. However, the application and Notes clearly identify County Bank as the lender and Main Street as the servicer. App. B at 6.

> location near your residence. This arbitration agreement is made pursuant to a transaction involving interstate commerce. It shall be governed by the Federal Arbitration Act, 9 U.S.C. Sections 1-16. . .

App. B at 6. The arbitration agreement is followed by a notice, which appears in capital letters:

> NOTICE: YOU AND WE WOULD HAVE HAD A RIGHT OR OPPORTUNITY TO LITIGATE DISPUTES THROUGH A COURT AND HAVE A JUDGE OR JURY DECIDE THE DISPUTES BUT HAVE AGREED INSTEAD TO RESOLVE DISPUTES THROUGH BINDING ARBITRATION.

Id.

In addition, the Note contains a separate agreement not to bring, join, or participate in class actions:

> *AGREEMENT NOT TO BRING, JOIN OR PARTICIPATE IN CLASS ACTIONS:* To the extent permitted by law, you agree that you will not bring, join or participate in any class action as to any claim, dispute or controversy you may have against us, our employees, officers, directors, servicers and assigns. You agree to the entry of injunctive relief to stop such a lawsuit or to remove you as a participant in the suit. You agree to pay the attorney's fees and court costs we incur in seeking such relief. This Agreement does not constitute a waiver of any of your rights and remedies to pursue a claim individually and not as a class action in binding arbitration as provided above.

Id.

Immediately above Muhammad's signature is the following notice, again printed in capital letters:

> BY SIGNING BELOW, YOU AGREE TO ALL OF THE TERMS OF THIS NOTE, INCLUDING THE AGREEMENT TO ARBITRATE ALL DISPUTES AND THE AGREEMENT NOT TO BRING, JOIN OR PARTICIPATE IN CLASS ACTIONS. YOU ALSO ACKNOWLEDGE RECEIPT OF A FULLY COMPLETED COPY OF THIS NOTE.

Id. at 6-7.

Although Muhammad agreed to arbitrate disputes and not to bring, join or participate in class actions, she filed a putative class action in New Jersey state court. *Id.* at 7. Arguing federal preemption, Petitioners timely removed the action from state court to federal court, but the case was remanded in June, 2004. *Id.*

The New Jersey Superior Court's Trial Division granted Petitioners' motion to stay proceedings and compel arbitration, after reviewing New Jersey case law and finding that, although the arbitration agreement was an adhesion contract, it could be enforced, including the class action waiver it contained.

The Superior Court's Appellate Division heard Muhammad's appeal and again ruled in favor of enforcing the arbitration agreement. The Appellate Division analyzed the plaintiff's unconscionability challenge in light of the four factors set forth by the New Jersey Supreme Court in *Rudbart v. North Jersey Dist. Water Supply Comm'n*, 127 N.J. 344, 353, 605 A.2d 681 (1992). Balancing the strong federal and New Jersey state policy favoring arbitration, the appellate court determined that the arbitration agreement was enforceable as written.

Rejecting plaintiff's argument that the class action waiver itself made the arbitration agreement unenforceable, the Appellate Division relied on *Gras v. Associates First Capital Corp.*, 346 N.J. Super. 42, 47, 786 A.2d 886 (App.Div. 2001), cert. denied, 171 N.J. 445, 794 A.2d 184 (2002), which had held that an arbitration agreement precluding class actions was not void as against the public policy of the state of New Jersey.

The New Jersey Supreme Court granted Muhammad leave to appeal. Overturning the two lower courts, the New Jersey Supreme Court found that an arbitration agreement containing a class action waiver was unconscionable and thus unenforceable in cases where small value claims might be brought.

The court distinguished *Gras* based on the fact that Muhammad's claim was considered one of a new class of "low value" claims that triggered the state law on unconscionability. The court did not set a dollar amount or other standard for determining in future cases whether a claim was large enough for *Gras'* holding to apply (as in the *Delta Funding Corp. v. Harris*, 2006 WL 2277984 (N.J. 2006) case decided by the court on the same day and reprinted here at App. D), or small enough for its holding in *Muhammad* to apply.

BASIS FOR GRANTING THE WRIT OF CERTIORARI

I. THE COURT SHOULD GRANT CERTIORARI TO DETERMINE WHETHER THE FAA PREEMPTS STATE-LAW RULES REQUIRING CLASS-ACTION PROCEDURES TO BE SUPERIMPOSED ON ARBITRATION.

Long before the state and federal conflicts over the enforceability of arbitration agreements reached as far and wide as they do today, this Court ordered briefing and argument on the question whether, if state law required "superimposing class-action procedures on a contract arbitration," it would conflict with the FAA and thus violate the Supremacy Clause. *Southland*, 465 U.S. at 8. In 1987, this Court concluded that it lacked jurisdiction to decide the issue because the appellant "did not contend in the California courts that, and the state courts did not decide whether, state-law imposing class-action procedures was pre-empted by federal law." *Id.*

Today the question is neither rhetorical nor hypothetical. The present case exemplifies the minority view on a long-simmering and important issue that now has created conflict among the states and the federal circuits. The question divides state courts within the same state, federal courts across the circuits, and even federal and state courts within the same circuit. This issue is of great importance not only to the petitioners, but also to all U.S. companies whose interaction with consumers may possibly fall within the new and nebulous sub-category of so-called "low value" claims.

Petitioners preserved this issue for review by raising the preemption argument as soon as the New Jersey Supreme Court issued an opinion contrary to the FAA. In their motion for reconsideration, Petitioners expressly questioned

whether the New Jersey Supreme Court's ruling was preempted in a motion for reconsideration. The motion for reconsideration is reprinted at App. F.

A. The New Jersey Supreme Court Ruling Conflicts With The Decisions Of Multiple Other Federal And State Courts, Including The Third Circuit.

The New Jersey Supreme Court's ruling that an arbitration agreement containing a class waiver is unconscionable in "low value" cases conflicts with other courts that have considered the issue. Among the state courts, California also has determined that an otherwise valid arbitration agreement containing a class action waiver is unconscionable in small consumer claims. *Discover Bank v. Superior Court*, 36 Cal. 4th 148, 30 Cal. Rptr. 3d 76, 113 P.3d 1108 (2005). Supreme courts in Alabama, Illinois, and West Virginia have found arbitration clauses containing class action waivers invalid only where the arbitration clause contained other unfair provisions, such as limitations on claims, causes of action, or damages.[4] Appellate courts in Florida, Missouri, and Pennsylvania also have invalidated

[4] *See Leonard v. Terminix International Co.*, 854 So.2d 529, 538-39 (Ala.2002) (striking clause that also limited recovery of damages); *Kinkel v. Cingular Wireless LLC*, 223 Ill.2d 1, 857 N.E.2d 250, 306 Ill.Dec. 157 (2006) (clause did not contain a provision under which the company would pay arbitration costs, did not provide for recovery of attorney's fees if permitted by applicable law and limited punitive damages); *State ex rel. Dunlap v. Berger*, 211 W.Va. 549, 567 S.E.2d 265 (W.Va. 2002) (prohibiting punitive damages), *cert. denied, sub nom., Friedman's, Inc. v. West Virginia ex rel. Dunlap*, 537 U.S. 1087 (2002).

agreements where the class waiver was accompanied by unfair limits on claims and damages.[5]

Most state courts to have considered this issue have upheld arbitration agreements containing class action waivers. State courts in Illinois[6] and Texas[7] have held, like the Tennessee Court of Appeals, that, regardless of any state-law concern about "the unavailability of class action relief," "the Supremacy Clause of the Federal Constitution. . . preclude[s] [a court] from invalidating an arbitration agreement otherwise enforceable under the FAA simply

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[5] *Powertel, Inc. v. Bexley*, 743 So.2d 570, 575-76 (Fla.App.1999), review denied, 763 So.2d 1044 (Fla. 2000) (company's liability limited only to actual damages, no provision allowing injunctive or declaratory relief as provided for in state statute); *Bellsouth Mobility LLC v. Christopher*, 819 So.2d 171, 173 (Fla.App. 2002) (same); *Whitney v. Alltel Communications, Inc.*, 173 S.W.3d 300, 313-14 (Mo.App.2005) (arbitration agreement required consumer to bear own costs, making it prohibitively expensive); *Thibodeau v. Comcast Corp.*, 2006 WL 3457582 (Pa.Super. 2006)(Nos. 2176 EDA 2005, 2117 EDA 2005) (one-sided clause effectively forced consumer to arbitrate but left access to court open to corporation).

[6] *Hutcherson v. Sears Roebuck & Company*, 342 Ill. App. 3d 109, 793 N.E. 2d 886 (Ill. App. 2003), rev. denied (class action waiver is not unconscionable under Arizona law, and FAA requires class action waiver to be enforced in accordance with its terms).

[7] *AutoNation USA Corporation v. Leroy*, 105 S.W. 3d 190 (Tex. 2003) (right to arbitrate under the FAA trumps right to maintain a class action).

because a plaintiff cannot maintain a class action." *Pyburn v. Bill Heard Chevrolet*, 63 S.W.3d 351, 365 (Tenn. Ct. App. 2001).[8]

State courts in Delaware, the District of Columbia, Hawaii, Kansas, Maine, Maryland, New York, and North Dakota, have determined, like the state of Colorado, that class action waivers are not unconscionable under state law. *Rains v. Foundation Health Systems Life & Health*, 2001 Colo. App. LEXIS 580 (Ct. App. Colo. Mar. 29, 2001)(No. 99CA2398,) No. 99CA2398 ("arbitration clauses are not unenforceable simply because they might render a class action unavailable").[9]

The federal courts of appeal split along roughly the same lines. The First Circuit and the Ninth Circuit have held that arbitration agreements containing class action waivers are unconscionable. *Ting v. AT&T*, 319 F.3d 1126 (9th Cir. 2003), cert. denied, 540 U.S. 811 (2003) (following California Court of Appeal's opinion in *Szetela v. Discover*

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[8] The Tennessee Supreme Court denied the plaintiff's petition for review in that case and ordered the state court of appeals decision published (63 S.W.3d at 351), which means that the decision "may be relied upon by the bench and bar of [Tennessee] as representing the present state of the law with the same confidence and reliability as the published opinions of [the Tennessee Supreme] Court." *Meadows v. State*, 849 S.W.2d 748, 752 (Tenn. 1993).

[9] *See Strand v. U.S. Bank National Ass'n* , 2005 ND 68, 693 N.W.2d 918, 926 (2005); *Walther v. Sovereign Bank*, 386 Md. 412, 438-42, 872 A.2d 735, 750-53 (2005); *Brown v. KFC National Management Co.*, 82 Haw.226, 921 P.2d 146 (1996); Stenzel v. Dell, Inc., 870 A.2d 133 (Me. 2005); *Forest v. Verizon Communications*, 805 A.2d 1007 (D.C.App. 2002) (upholding validity of forum selection clause despite unavailability of class actions in that forum); *Ranieri v. Bell Atlantic Mobile*, 759 N.Y.S.2d 448, 304 A.D.2d 353, app. denied, 1 N.Y. 3d 502, 807 N.E. 2d 290 (2003); *Pick v. Discover Financial Services*, 2001 WL 1180278 (D. Del. 2001)(No. 00-935-SLR).

Bank, 97 Cal. App. 4th 1094 (2002) and holding that class action waiver is unconscionable under California law); *Kristian v. Comcast Corp.*, 446 F.3d 25 (1st Cir. 2006) (finding recovery in antitrust case so small as to make class action waiver unconscionable).

In contrast, a federal district court in West Virginia recently rejected the state supreme court's holding that arbitration provisions containing class waivers are unconscionable when the damages sought are small, finding that holding to be preempted by the FAA. *Schultz v. AT&T Wireless Servs., Inc.*, 376 F. Supp. 2d 685, 691 (N.D. W.Va. 2005).

The Fifth[10] and Eleventh[11] Circuits, while not weighing in on the preemption issue specifically, reached the same conclusion by finding that state laws conditioning the enforceability of an arbitration provision on the availability of class-wide arbitration are incompatible with the objectives of arbitration.

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[10] *Iberia Credit Bureau*, 379 F.3d 159, 174 (quoting *Gilmer*, 500 U.S. at 31) ("the fact that certain litigation devices may not be available in an arbitration is part and parcel of arbitration's ability to offer 'simplicity, informality, and expedition,' characteristics that generally make arbitration an attractive vehicle for the resolution of low-value claims.").

[11] *Caley v. Gulfstream Aerospace Corp.*, 428 F.3d 1359, 1378 (11th Cir. 2005) (quoting *Gilmer*, 500 U.S. at 31)(finding that prohibition of class arbitration is "consistent with the goals of 'simplicity, informality, and expedition' touted by the Supreme Court in *Gilmer*.").

The Second, Fourth, Sixth, Seventh, and Eighth federal Circuits have all found,[12] like the Third Circuit, that the procedural right to a class action is waivable, and that an arbitration agreement containing a class action waiver is fully enforceable. *Johnson v. West Suburban Bank*, 225 F.3d 366, 374 (3d Cir. 2000), s*ee Lloyd v. MBNA Am. Bank, N.A.*, 27 Fed. Appx. 82, 84 (3d Cir. 2002).

The *Johnson* opinion creates an extremely troubling conflict over the arbitration issue. Under *Johnson*, the class waiver in this case would be enforceable in a federal court sitting in New Jersey but, under *Muhammad*, is not enforceable in state courts there. That express conflict between the circuit and state courts invites forum shopping, and places companies in an untenable position: they cannot manage litigation risks because that risk will be solely determined by the court in which a potential case is brought.[13]

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[12] *JLM Industries, Inc. v. Stolt-Nielson SA*, 387 F.3d 163 (2nd Cir. 2004); *Snowden v. Checkpoint Check Cashing*, 290 F.3d 631, 638 (4th Cir. 2002); *Burden v. Check into Cash of Kentucky, LLC*, 267 F.3d 483 (6th Cir. 2001); *Caudle v. American Arbitration Association*, 2000 WL 1528950 (7th Cir. Oct. 17, 2000) (No. 00-1423), *In re Piper Funds, Inc.*, 71 F.3d 298 (8th Cir. 1995).

[13] This Court has long recognized that, "[i]f the federal court allows arbitration where the state court would disallow it, the outcome of litigation might depend on the courthouse where suit is brought." *Bernhardt v. Polygraphic Co.*, 350 U.S. 198, 203 (1956). The converse, of course, is equally true: Parties to a contract affecting interstate commerce may not avoid arbitration by filing their action in a state court when, had the action been brought in federal court, they would have been compelled to arbitrate. *See Burke Co. Public Sch. Board of Education v. Shaver Partnership*, 303 N.C. 408 (1981). To prevent such conflicts, Congress specifically imbued the FAA with preemptive force—where state and federal law would result in disparate rulings, the state burdening arbitration while federal law promotes it, the federal law must govern.

The forum shopping concern is only one of many reasons this issue is deeply important to companies who regularly contract with consumers. All entities, from cable and wireless service providers to finance and credit card companies, are at the mercy of state and federal courts, which may decide that the claims stemming from their service contracts are "low" enough to render their arbitration agreements unconscionable. In New Jersey alone, the issue is paramount. If a consumer with more loans than Muhammad were to bring a claim, it may or may not be large enough to merit enforceability under *Delta Funding* or *Muhammad.*

Petitioners, an out of state bank and a loan servicing company, are powerless to determine how the new rule will be applied, and even if they could determine how the New Jersey rule will be applied, they would not be able to consistently apply this rule outside of New Jersey. The New Jersey ruling forecasts 50 disparate state laws, each unique and potentially different from the law of the federal circuits sitting in those states, all amounting to a contracting and litigation nightmare for interstate commerce. Tens of millions of potential contracts, including thousands of County Bank's own agreements, are threatened as a result. *See* App. G (United States Chamber of Commerce, as *amici* to the New Jersey Supreme Court, discussing the impact on its 3,000,000 member businesses.)

B. The FAA Preempts New Jersey's Rule That Class Action Waivers Are Unconscionable In Low Value Cases.

The FAA "declared a national policy favoring arbitration and withdrew the power of the state to require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration." *Southland*, 465 U.S. at 10. "[M]otivated, first and foremost, by a

congressional desire to enforce agreements into which parties had entered," the Act was passed to "ensure judicial enforcement of privately made agreements to arbitrate," placing arbitration agreements "upon the same footing as other contracts." *Dean Witter Reynolds Inc. v. Byrd*, 470 U.S. 213, 219, 220 (1985); *see Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 53-54 (1995) (Arbitration Act's "central purpose" is "to ensure 'that private agreements are enforced according to their terms' ") (quoting *Volt Info. Sciences, Inc. v. Board of Trustees of Leland Stanford Junior Univ.*, 489 U.S. 468, 479 (1989)).

To carry out the FAA's central purpose, state and federal courts are instructed to "rigorously enforce agreements to arbitrate, even if the result is 'piecemeal' litigation." *Dean Witter Reynolds*, 470 U.S. at 221 (quoting *Moses H. Cone Mem. Hosp. v. Mercury Const. Corp.*, 460 U.S. 1, 20 (1983)); *Perry v. Thomas*, 482 U.S. 483, 489 (1987). And under the Supremacy Clause, state laws in conflict with the FAA's strong policy in favor of arbitration must give way. *See, e.g., Perry*, 482 U.S. at 484 (finding preempted a California law allowing certain actions to be maintained in court " 'without regard to the existence of any private agreement to arbitrate' ") (quoting Cal. Lab. Code Ann. § 229); *Southland*, 465 U.S. at 11-12 (finding preempted a California law interpreted by state courts to require judicial consideration of claims).

In declaring class arbitration waivers unenforceable in "low" value cases, the New Jersey Supreme Court placed its own policy preference for class actions squarely above Congress's policy of ensuring the enforcement of arbitration agreements as written. *See, e.g., Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 53-54 (1995); *Volt Info. Scis., Inc. v. Bd. of Trs. of Leland Stanford Jr. Univ.*, 489 U.S. 468, 479 (1989); *Dean Witter Reynolds Inc. v. Byrd*, 470 U.S. 213, 219-221 (1985). When state and

Congressional policies clash, Congress prevails. *Perry v. Thomas*, 482 U.S. 482, 491 (1987).

This Court also has made clear that state law is preempted whenever it "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *Fid. Fed. Sav. & Loan Ass'n v. de la Cuesta*, 458 U.S. 141, 153 (1982) (internal quotation marks omitted); *see also Geier v. Am. Honda Motor Co.*, 529 U.S. 861, 869- 874 (2000); *United States v. Locke*, 529 U.S. 89, 109 (2000). New Jersey's rule conditioning enforcement of arbitration provisions on the value of the claim and whether class arbitration is permitted threatens Congress' primary objective in enacting the FAA and therefore is preempted because it applies *only* for the narrow class of terms or agreements relating to the procedures available to claimants in arbitration, and *only* to certain entities whose business may generate small dollar consumer claims.

The enforceability of an arbitration agreement does not and cannot depend on the value of the claims sought to be arbitrated. To subject arbitration agreements to such an *ad hoc* standard for enforceability, which is not generally applicable to other types of contracts, violates the FAA. *See Martindale v. Sandvik, Inc.*, 173 N.J. 76, 86 (N.J. 2002) (quoting *Perry v. Thomas*, 482 U.S. at 492 n.9 (1987) ("[S]tate law. . . is applicable if that law arose to govern issues concerning the. . . enforceability of contracts generally." However, states may not "decide that a contract is fair enough to enforce all its basic terms . . . but not fair enough to enforce its arbitration clause" because "that kind of policy would place arbitration clauses on an unequal 'footing,' directly contrary to the Act's language and Congress' intent.").

The FAA permits states to enforce or reject arbitration agreements on "grounds as exist at law or in equity for the

revocation of any contract." 9 U.S.C. § 2. The unconscionability rule applied in this case, however, is not a ground that exists for any contract, but rather only for the arbitration agreements that waive class treatment, and only to certain entities whose business may generate claims falling within the newly created subcategory of cases that the New Jersey Supreme Court ambiguously named "low value consumer claims."

This arbitrary line between "low value" and "high value" loans will prove unworkable in practice, because it necessarily would invite courts to draw *post hoc*, arbitrary lines between claims that are substantial "enough" to merit individual arbitration and claims that are thought to be too small to justify it, and without knowing the size of claims to be asserted by other members of the putative class. Compare, *Muhammad* with *Delta Funding*; *see Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265, 282 (1995) (O'Connor, J., concurring) (emphasizing that courts should avoid interpreting FAA in a way that would "foster pre-arbitration litigation that would frustrate the very purpose of the statute"). If this line should be drawn, Congress is in the best position to draw it.

C. The Court Should Grant Certiorari To Resolve The Question It Previously Raised But Did Not Resolve in *Southland Corp. v. Keating*.

In *Keating v. Superior Court*, 645 P.2d 1192, 1195 (Cal. 1982), the plaintiff franchisees brought a class action against their franchisor alleging numerous state law claims. The trial court granted Southland's motion to compel arbitration of the plaintiffs' claims and ordered that the arbitration proceed as a "class arbitration"—even though the parties' agreement did not specify that a class procedure was available in arbitration. The California Supreme Court

granted review of the question whether the trial court could impose class action procedures on the parties. Advancing the same policy rationales the New Jersey Supreme Court identified in this case, the California Supreme Court concluded that the arbitration could go forward as a class proceeding, if the trial court concluded on remand that "gross unfairness" would otherwise result. *Id.* at 1209. Three dissenting justices observed that "[a]rbitration is a matter of agreement," and that the parties' arbitration contracts "do not provide for class arbitration, nor have the parties subsequently agreed thereto." *Id.* at 1214.

This Court noted probable jurisdiction over the question "whether arbitration under the federal Act is impaired when a class-action structure is imposed on the process by the state courts." *Southland*, 465 U.S. at 3. This Court ultimately dismissed that question for lack of jurisdiction, finding that the class arbitration procedure had been challenged below on state law grounds only. *Id.* at 9.

This case raises the same question left unanswered in *Southland*, with two significant twists. First, the parties' arbitration agreement in *Southland* was silent as to whether class action procedures were available in arbitration. In contrast, County Bank's arbitration agreement with Muhammad ***expressly precluded*** class action procedures. Second, the court determined that this revision was appropriate only in consumer cases likely to generate "low value" claims. Thus, for companies doing business in New Jersey, class waivers are available only if the companies' interaction with consumers does not generate "low value" claims, notwithstanding what the parties' agreement actually provides. Only if the claim is large enough – and "large enough" is to be determined case by case with no guidance – will the parties be permitted to arbitrate their claims as agreed.

The jurisdictional impediments to review in *Southland* do not exist here. The question whether the FAA precludes the state court from writing class procedures into the parties' arbitration agreement was raised below on a motion for reconsideration – the first opportunity to do so.[14]

II. THE NEW JERSEY SUPREME COURT'S RULING DENIES PETITIONERS DUE PROCESS BY RETROACTIVELY ENFORCING A NEW INTERPRETATION OF NEW JERSEY LAW.

In *Muhammad*, the New Jersey Supreme Court articulated a new legal principle and applied it retroactively to the Petitioners, thus violating Petitioners' procedural due process rights. In its Opinion, the New Jersey Supreme Court expressly noted that the issue of class arbitration "specifically has never before been examined by this Court." App. A at 17-18.

New Jersey law prior to *Muhammad* held that a waiver of certain rights in an arbitration clause would be enforced so long as they were sufficiently notorious and specific. *Gras v. Associates First Capital Co.*, 346 N.J. Super. 42, 49-57 (App. Div. 2001), *cert. denied*, 171 N.J. 445 (2002). As shown above, pp. 8-9, the provisions here were both specific and notorious. In *Muhammad*, the Court created a new rule that distinguished between "low value" and "high value" claims in determining that a class arbitration waiver is unconscionable and unenforceable when it involves an undefined small amount of money. Meanwhile, a separate ruling on the same day in *Delta Funding*, *supra*, held that such waivers *were* enforceable and not unconscionable when

[14] Prior to the New Jersey Supreme Court's ruling, the lower trial courts had ruled in compliance with the FAA, and no preemption question existed.

they involved a larger monetary claim. App D at 10. Prior to *Muhammad* and *Delta Funding*, New Jersey law did not differentiate between "low value" and "high value" claims.

If applied at all, the new distinction cannot be applied retroactively to the parties here because to do so would cause manifest injustice. "Retroactivity is not favored in the law." *Bowen v. Georgetown Univ. Hospital*, 488 U.S. 204, 208 (1988), *see* H. Broom, Legal Maxims 24 (8th ed. 1911) ("Retrospective laws are, as a rule, of questionable policy, and contrary to the general principle that legislation by which the conduct of mankind is to be regulated ought to deal with future acts, and ought not to change the character of past transactions carried on upon the faith of the then existing law"). Federal law establishes that there are explicit and implied limitations on the legislature's power to impose laws retroactively. Article I, Section 10 of the U.S. Constitution provides that "[n]o State shall. . . pass any. . . law impairing the obligation of contracts." Just as legislatures are barred, so are the courts. All statutes with retroactive elements are subject to scrutiny under the due process clause of the Fourteenth Amendment of the U.S. Constitution. U.S. Const. amend. XIV, § 1.

A court may not automatically apply a change in the law retroactively where the application of that law attaches new legal consequences to completed, past conduct that was legal at the time. *Usery v. Turner Elkhorn Mining Co.*, 428 U.S. 1, 15-16 (1976). If a decision establishes a new principle of law by overruling past precedent or by deciding an issue of first impression, it should be applied only prospectively. *Coons v. American Honda Motor Co.*, 96 N.J. 419, 427, 476 A.2d 763 (1984), cert. denied, 469 U.S. 1123, 105 S.Ct. 808, 83 L.Ed.2d 800 (1985).

If allowed to stand, the Court's ruling in *Muhammad* will effectively invalidate thousands of existing contracts in

which the parties expressly waived certain rights to court proceedings and class actions. The decision also impacts every lender and merchant offering credit cards to New Jersey residents on the basis of the protection provided by the previous law and their legally valid agreements. Retail sales companies and basic service providers are laid open to massive unplanned litigation risk. Such a sweeping application of a fact-specific analysis is arbitrary and irrational and cannot be the basis for retroactive application. *Usery*, *supra*, 428 U.S. at 15.

The ruling in *Muhammad* goes far beyond imposing additional, unnegotiated obligations on Petitioners. It imposes terms that directly contradict the express agreement of the parties. A retrospective application of the ruling in *Muhammad* will result in lengthy and expensive litigation that was not anticipated by either party at the time of entering into the contract, and it will have the chilling effect of discouraging other businesses from lending in this so-called "low value" arena, an area in which customers arguably need additional options, not fewer.

III. THE RULING BELOW UNDULY BURDENS INTERSTATE COMMERCE BY SEEKING TO IMPOSE DISPARATE REQUIREMENTS ON ARBITRATION AGREEMENTS MADE IN THE INTERSTATE MARKET.

Section 2 of the FAA declares pre-dispute arbitration agreements "valid, irrevocable, and enforceable" because "arbitration saves time, saves trouble, saves money." Joint Hearings on S. 1005 and H.R. 646 Before the Subcomms. of the Comms. on the Judiciary, 68th Cong., 1st Sess. 7 (1924) (statement of Charles Bernheimer, N.Y. Chamber of Commerce); *see also* H.R. Rep. No. 68-96, at 2 (1924) ("the costliness and delays of litigation. . .can be largely eliminated by agreements for arbitration, if arbitration

agreements are made valid and enforceable"). As Congress later explained, arbitration usually is "cheaper and faster than litigation," has "simpler procedural and evidentiary rules," "minimizes hostility," and is "more flexible in regard to scheduling." H.R. REP. No. 97-542, at 13 (1982). This Court, too, has recognized the superior "simplicity, informality, and expedition of arbitration." *Mitsubishi Motors Corp. v. Soler ChryslerPlymouth, Inc.*, 473 U.S. 614, 628 (1985); *see also Dean Witter*, 470 U.S. at 221 (recognizing that twin goals of FAA are "enforcement of private agreements [to arbitrate] and encouragement of efficient and speedy dispute resolution").

Class-action procedures, by contrast, severely hinder the low-cost and efficient resolution of disputes that is the hallmark of arbitration. Class actions first require a lengthy class certification proceeding. If, after extensive discovery and hearings, a class is certified, there must be full and adequate notice to class members and an opportunity to opt out. Discovery commensurate with the now-increased stakes of the litigation begins next and often continues for years. If the defendant settles to curtail increasing costs, another round of notice followed by a fairness hearing, complete with extensive briefing by both sides and by any objectors then follows. If the defendant chooses not to settle, a class-wide trial follows - one in which the parties must present the common and individualized elements of their claims and defenses.

Forcing Petitioners to defend against the time-consuming and expensive class action procedures over a previously negotiated waiver of those proceedings eliminates the distinction between arbitration and litigation, but also presents businesses with an impossible scenario. While class arbitration would increase the stakes exponentially over an individual arbitration, any classwide arbitral award would remain reviewable only for fraud, corruption or bias, see 9

U.S.C. § 10, or "manifest disregard" of the law, see *Wilko v. Swan*, 346 U.S. 427, 436-437 (1953), overruled on other grounds by *Rodriguez de Quijas v. Shearson/Am. Express, Inc.*, 490 U.S. 477 (1989).

This standard of review often will be insufficient to avoid an erroneous, yet potentially massive, class-wide judgment. Precluding class waivers also is contrary to the goals of the arbitration process – to provide an efficient and cost effective way to resolve disputes. As Justice Thomas has explained, a rule that "discourages the use of arbitration agreements" is "completely inconsistent with the policies underlying the FAA." *EEOC v. Waffle House, Inc.*, 534 U.S. 279, 310 (2002) (Thomas, J., dissenting); *see also Iberia Credit Bureau, Inc. v. Cingular Wireless LLC*, 379 F.3d 159, 175-176 (5th Cir. 2004) (for parties to demand "all of the procedural accoutrements that accompany a judicial proceeding" would undermine "the point of arbitration").

By eliminating the class waiver from thousands of County Bank contracts, New Jersey's rule disproportionately burdens arbitration and hence violates the Commerce Clause. *Cf. Best & Co. v. Maxwell*, 311 U.S. 454, 455 (1940) ("The commerce clause forbids discrimination, whether forthright or ingenious."). Should the current conflict in the law persist, the enforceability of form contracts containing arbitration provisions will vary from state to state based on the *ad hoc* policy judgments of the various states' courts as to whether the arbitration provision (or some feature of it) shocks the conscience. In fact, as demonstrated here, enforceability of the same form contract could differ in different cases within the same state, should the state choose to draw additional lines between types of claims (as here), or types of consumers, or types of services.

The uncertainty created by New Jersey's *ad hoc*, state specific approach is a burden not just on arbitration, but also

on interstate commerce. *See BMW of North America, Inc. v. Gore*, 517 U.S. 559, 570-571 ("[O]ne state's power to impose burdens on the interstate market [through a state court's actions in a civil case]. . .is not only subordinate to the federal power over interstate commerce, but is also constrained by the need to respect the interests of other states.") (internal citations omitted). This Court has long stated that the Constitution is equally concerned with state regulation and Congressional regulation of interstate commerce, *see Healy v. Beer Institute*, 491 U.S. 324, 335-336 (1989), but that state regulation attempting to upset that balance must give way to the FAA. *See Southland*, 465 U.S. at 15 ("We are unwilling to attribute to Congress the intent, in drawing on the comprehensive powers of the Commerce Clause, to create a right to enforce an arbitration contract and yet make the right dependent for its enforcement on the particular forum in which it is asserted.").

The New Jersey rule disproportionately burdens arbitration and interstate commerce and must not be allowed to stand. Only Congress, not individual states, has the power to do so.

CONCLUSION

State and federal courts have been seeking resolution to the arbitration questions presented in *Muhammad* for 20 years since this Court raised the preemption question in *Southland*. Certiorari should now be granted and the decision of the New Jersey Supreme Court should be reversed so that the multi-level conflicts, *ad hoc* adjudication, and upheaval in interstate commerce may end, allowing arbitration to move forward as Congress originally intended.

Respectfully submitted,

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